FINANCIAL SERVICES

PROVIDING INCLUSIVE AND SUSTAINABLE FINANCIAL SOLUTIONS

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Guided by regulators and market-led efforts, the Financial Services NKEA has achieved significant progress in developing Malaysia's financial industry, especially in improving her regional competitiveness in line with the financial system needs of a high-income nation. The Government has also outlined three strategic areas to further strengthen Malaysia's economic resilience while driving inclusive and sustainable economic growth for years to come. These comprise ensuring well-distributed economic growth and development to provide equal opportunities to those in small townships and rural areas; positioning Malaysia as a competitive market for the digital economy; and leveraging financial technology as an enabler to fortify the resilience and sustainability of the financial system.

The NTP has been contributing to these areas, with this NKEA paving the way for universal access to insurance for the rakyat, while regulators and market players have rapidly taken up opportunities presented by financial technology. Other indicators, such as the value of the capital, equity and debt markets, the fund management industry's Assets under Management (AuM) and Malaysia's share of global Islamic assets under management also reflect the continued resilience and global prominence of our financial system. As at the end of the year, the value of the capital, equity and debt markets amounted to RM3.2 trillion, RM1.9 trillion and RM1.3 trillion respectively, while AuM stood at RM776.2 billion. Of the US$71 billion global market value of Shariah assets, Malaysia commands a 30% share and is also the global leader of sukuk issuances. These contributed to the RM73.9 billion in GNI created by the NKEA in 2017, accounting for 6% of total GNI generated.

Furthermore, the Malaysian financial system has become more regionally integrated to support stronger economic and financial linkages, as reflected by the presence and activity of Malaysian commercial banks in ASEAN. Beyond banking integration, other initiatives to strengthen economic and financial integration in ASEAN include the ongoing promotion of local currency settlement arrangements between ASEAN countries with banks serving as key enablers in these mechanisms, the deepening of regional financial markets, increasing interconnectedness and safety of payment systems as well as enhancing financial inclusion.

The banking industry is facing rapid and irreversible forces of change across technology, customer behaviour and regulation. The effect is that the industry's current shape and operating models may no longer be competitive and sustainable in the long-run.

The Ministry fully believes that with proper harnessing, technology will help to broaden retail investor participation and stimulate more innovative, market-based financing options. The digitisation of the financial services value chain will also make it easier for consumers to access financial services. This will help address funding challenges faced by the Malaysian business community, especially for the micro, small and medium-sized enterprise segment and in the long-term, further enriching our financial services industry in tandem with our transformation into a high-income nation by 2020.

ENCOURAGING FINANCIAL PROTECTION IN AN INCLUSIVE MANNER

Insurance and takaful penetration in Malaysia has ranged between 54% and 56% between 2012 and 2017. Bank Negara Malaysia (BNM) targets to increase this to 75% by 2020. To increase the uptake of insurance and takaful among Malaysians, BNM has been undertaking a number of initiatives. This includes working with the insurance and takaful industry to introduce a diverse range of affordable, accessible and simple products intended to meet the needs of the underserved household segment. In addition to increasing insurance and takaful coverage among Malaysians, the initiative is also expected to heighten awareness of insurance and takaful over the longer term.

Another key initiative is to diversify distribution channels for insurance products. The insurance and takaful industry has begun offering life insurance products through direct channels since July 2017, particularly through the digital space. As a result, protection-focused products are now available via cost-efficient distribution channels. This will enable the development of product comparison websites and further catalyse innovation for protection-focused products.

EMBRACING DIGITAL FINANCE AND REINVENTING THE FUTURE

Following the new peer-to-peer (P2P) financing framework which came into effect on 2 May 2016 and the registration of financing platform operators, RM37.15 million of financing has been issued through these platforms. The introduction of P2P financing follows the launch of equity crowdfunding (ECF) in 2015, making it the second market-based financing asset class in Malaysia. Since the operationalisation of the ECF market in mid-2016, 37 issuers have raised a total of RM32.74 million through ECF operators as of December 2017.

In 2017, the Securities Commission (SC) introduced the Digital Investment Management framework, setting out licensing and conduct requirements for the offering of automated discretionary portfolio management services to investors, making investments affordable and accessible to everyone, at all stages of their lives.

This also calls for the evolution of a more comprehensive ecosystem for innovation which includes incubator programmes that are proving to be highly successful in helping entrepreneurs commercialise ideas and scale up companies. Such programmes can significantly reduce the cost of innovation for firms and risks for financiers and risk managers such as insurance providers. Malaysia's well-developed institutions also play a key role in partnership with financial institutions to support innovative financing solutions.

"Since the operationalisation of the ECF market in mid-2016, 37 issuers have raised a total of RM32.74 million through ECF operators as of December 2017."

In an effort to energise the digital agenda for Malaysia's capital market, SC through its aFINity (alliance of FinTech Community) outreach programme has prioritised engagements with start-ups, technopreneuers, incumbent capital market participants, sectoral players and other stakeholders. It also launched Engagement Labs in 2017 with interested parties to delve into the key aspects of digital business and raise understanding in its deployment in the Malaysian capital market.

On its part, BNM has enhanced its regulatory approach to digital finance with the introduction of the Regulatory Sandbox on 18 October 2016. Under the Sandbox, financial institutions regulated by BNM and fintech companies looking to carry out businesses regulated by BNM may be granted certain regulatory flexibilities to experiment with innovative solutions in a production or live environment accompanied by appropriate safeguards. A Sandbox may be deployed for a period not exceeding 12 months, and thus six fintech companies have been approved to test their solutions in the Sandbox.

To attract more digital natives, Bursa Malaysia has refreshed its BursaMktPlc online platform which is aimed at improving financial literacy, educating and empowering investors to participate in the next generation of growth and creation of economic value. The website contains information about the Malaysian financial markets, including research reports, and serves to equip potential investors with knowledge on capital markets and provide experienced investors with tools to make investment decisions.

BUILDING A SUSTAINABLE SECURITIES CAPITAL MARKET

The equity capital market remained resilient in 2017 with support and collective efforts from the SC, Bursa Malaysia and industry players who work together to build a vibrant, robust and competitive marketplace with a continued focus on sustainability. In addition to expanding the market's range of tradable products, efforts are centred on facilitating greater market efficiency and accessibility, thus widening Malaysia's footprint in the regional marketplace.

The equity market has recorded significant gains since 2009, driven by Malaysia's stable economic growth. The FBMKLCI has risen by 105% during the period, with market capitalisation increasing by 187% and Average Daily Value (ADV) recording robust growth of 105%. The market has also recorded net inflows from foreign institutions of RM16.5 billion during the period from January 2010 to December 2017.

Total capital raising through the capital market amounted to RM146.7 billion in 2017. Primary market issuances amounted to RM132.1 billion, with a total of RM124.9 billion raised in the corporate bond and sukuk market, and RM7.4 billion raised via new equity listings. Notable IPOs for the year include Lotte Chemical Titan Holding Bhd (RM3.8 billion) and Eco World International Bhd (RM2.6 billion). RM14.5 billion was also raised via the secondary market through rights issues and private placements. Since 2010, the total capital raising in the capital market has reached close to RM900 billion.

As part of the amplified efforts to ensure a supportive market for issuers and investors, on 25 May 2017 Bursa Malaysia launched the Mid- and Small-Cap (MidS) Scheme, a platform to provide independent analyst coverage by licensed research houses for an inaugural batch of 100 mid- and small-cap public-listed companies (PLCs).

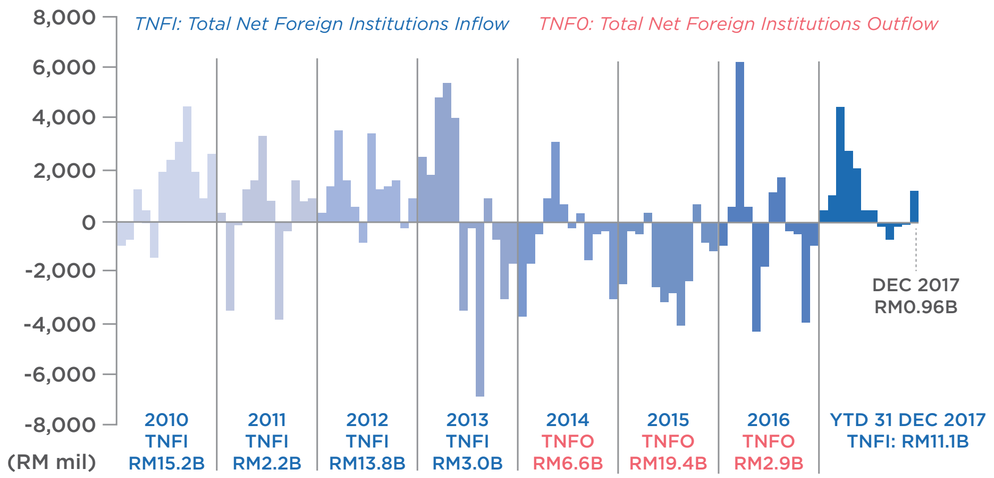
Malaysia Equity Market Growth from January 2009 through December 2017

FBM KLCI	105%
Market Capitalisation	187%
ADV	105%
Market Foreign Shareholdings	2.4 percentage points
Foreign Instituions Net Flow	2017 (inflow) **RM11.1 billion** 2014 - 2016 (Outflow) **RM28.9 billion** 2010 - 2013 (Inflow) **RM34.3 billion**

Source: Bursa Malaysia MIS

Foreign Institutions Net Inflows
January 2010 - December 2017

RM16.5 billion



Source: Bursa Malaysia MIS

ADVANCING MALAYSIA'S GLOBAL LEADERSHIP IN ISLAMIC FINANCE

In collaboration with the financial industry, BNM issued a Strategy Paper on Value-based Intermediation (VBI) in July 2017. VBI outlines a holistic approach for the Islamic finance industry to deliver the intended outcomes of Shariah finance. This includes processes and outcomes that generate positive and sustainable impact on the economy, community and the environment.

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The initial focus of VBI will be its implementation within the Islamic banking industry. Subsequently, it will be expanded to the takaful industry and other areas of the financial sector.

In line with the recommendation under the Financial Sector Blueprint, which seeks to position Malaysia as reference centre for the offering of Islamic financial products and services, BNM has also embarked on a Shariah Standards initiative. This initiative aims to develop a contract-based regulatory framework that is underpinned by standards on Shariah contracts which contain guidance on sound practices and effective governance.

From 2013 to 2016, 11 Shariah standards have been issued covering the policy documents on murabahah (cost and mark-up), mudharabah (profit sharing partnership), musyarakah (profit & loss sharing partnership), istisna' (construction), tawarruq (commodity trading), kafalah (guarantee), wakalah (agency), wadi'ah (safe custody), hibah (gift), qard (loan) and ijarah (lease).

The first half of 2017 saw the release of another policy document on wa'd (promise) and two exposure drafts on rahn (collateral) and bai' al-sarf (currency exchange) to the industry. The finalised policy documents on rahn and bai' al-sarf, which will be issued by the end of 2017, will mark the completion of the Shariah regulatory standards compendium which is widely applied in the Islamic finance industry.

Malaysia also continues to capitalise on the availability of Shariah compliant assets in its capital market. Furthermore, it is regulated on internationally benchmarked securities laws and practices. Malaysia already offers comprehensive Islamic capital market (ICM) capabilities with its Islamic funds and sukuk markets ranked as the largest in the world and supported by a sizeable Islamic equity market. The Islamic capital market nevertheless requires significant new drivers globally to build greater scale and elevate it to the next phase of growth. In this regard, the growing demand and preference for Islamic fund and wealth management services represent a new growth opportunity for ICM.

In view of this, the SC launched a five-year Islamic Fund and Wealth Management Blueprint in January 2017 to drive greater development and growth of Malaysia's Islamic capital market. Key initiatives will be operationalised based on three mutually reinforcing strategic thrusts. These will strengthen Malaysia's positioning as a global hub for Islamic funds, establish Malaysia as a regional centre for Shariah-compliant sustainable and responsible investment, and develop Malaysia as an international provider of Islamic wealth management services.

Leveraging on its strength in the Islamic capital market, the SC also developed a Sustainable and Responsible Investing (SRI) Fund framework, which will be instrumental in developing and branding Malaysia as a regional SRI market, further cementing the country's position as the largest SRI market in Asia. The framework details out the requirements that will have to be complied with by SRI funds, including additional disclosures.

Bursa Malaysia continued to register a healthy breadth of Shariah-compliant securities on the Main and ACE Markets. As of 31 December 2017, 76% of the 902 PLCs on Bursa Malaysia are Shariah-compliant with Shariah market capitalisation accounting for 60.5% of the total market capitalisation. Additionally, since its launch in September 2016, Bursa Malaysia-i has signed up 14 Islamic Participating Organisations (POs), almost half of the 30 POs currently registered with Bursa Malaysia Securities. POs are companies which carry out the business of dealing in securities.

ENABLING CAPITAL MARKET ACCESS TO SMALL PLAYERS

Given the importance of small- and medium-sized enterprises (SMEs) in driving Malaysia's economy, regulators have recognised the need to develop a supportive capital market-based fundraising mechanism for this important business segment. In line with this, Bursa Malaysia launched the Leading Entrepreneur Accelerator Platform (LEAP) on 25 July 2017. The first of its kind in ASEAN, designed solely for SMEs and sophisticated investors, the new market aims to provide SMEs with a fast and efficient fund-raising platform and visibility through the capital market. This initiative will contribute to enhancing SME fundraising activities in Malaysia.

The LEAP market offers several benefits to its various stakeholders. For example, it benefits issuers by providing an alternative and less costly platform for fundraising and provides sophisticated investors with access to a wider pool of potential investments that may yield high returns or provide investment diversification opportunities, while allowing advisers to enhance their profile and access additional revenue streams. Bursa Malaysia's launch of its MidS Scheme also served to catalyse the LEAP market ecosystem.

Moreover, two new indices were introduced as part of an initiative to track the performance and generate more interest in mid- and small-cap PLCs. The inclusion of the FTSE Bursa Malaysia MidS Cap Index and FTSE Bursa Malaysia MidS Cap Shariah Index into the FTSE Bursa Malaysia Index Series is in line with global trends where investors are now allocating their investment portfolio strategically into the mid- and small-cap segment. Mid- and small-cap stocks offer attractive growth prospects and provide greater opportunity for active managers to make informed decisions within the sector. Bursa Malaysia aims to further grow the two new equity segments and continue to drive sustainability in the marketplace by bringing new investable products to the market.

LEAP Market exchange of MoU and agreement on 25 July 2017.

ENABLING CONTINUED GROWTH OF THE CAPITAL MARKET

Given the overall size of the capital market, which now stands at more than RM3.2 trillion, the SC is establishing the Institute of Capital Market Research to further accelerate the market's growth momentum.

The Institute will benefit industry and policy makers by facilitating the introduction of innovative products and services through greater applied research, identifying new growth areas, developing more in-depth and rigorous research on capital market trends and issues, providing more analytical thinking for policy formulation as well as enhancing talent in the capital market via industry collaborations and strategic partnerships.

The Institute will also function as the central repository and reference point for capital market data and disseminate comprehensive statistics to facilitate analysis for the benefit of various industry participants, including undergraduate and post-graduate students undertaking research projects relating to financial markets, business and the economy.

MINISTRY OF FINANCE STEERING FINANCIAL SERVICES SECTOR TO A NEW ERA

Malaysia's financial services sector has emerged as a primary source of financing for the private sector to perform businesses and promote economic growth, says Datuk Siti Zauyah Md Desa, Deputy Secretary-General (Policy) of the Ministry of Finance. The financial services subsector constituted about 14% of the services sector, and the services sector, in turn, made up nearly 53% of Malaysia's GDP between 2010 and 2016.

Datuk Siti Zauyah says that the robust state of the financial industry is the outcome of careful planning and implementation of Government initiatives designed to strengthen the sector. These include the Financial Services NKEA under the NTP, the Financial Sector Masterplan (FSMP) 2000, Financial Sector Blueprint 2011 – 2020 (FSBP), the Capital Market Masterplan 2 (CMP2) and measures taken under the 11th Malaysia Plan (11MP).

Moves taken to develop the financial industry in the country include initiatives to improve levels of governance, competitiveness, regional integration and inclusion. The Government has also taken measures to make financial services more supportive of entrepreneurship and innovation.

Datuk Siti Zauyah adds that in order for Malaysia's financial service sector to be more competitive, it needed to be efficient and inculcate integrity. "The sector has to have a good communication strategy to educate the stakeholders and this could be done effectively through digitalisation and online transactions."

She also says that Malaysia needs to establish strategic partnerships with countries in the region, for example Islamic Finance and Public-Private Partnership for Infrastructure Development, to bridge the gap between the demand and supply of capital.

"At the same time, we need to distribute the relevant risks and return in a manner which is fair for all parties involved and more importantly, incentivise good operational performance," says Datuk Siti Zauyah.

The Deputy Secretary-General also notes that with the progressive liberalisation achieved in the banking, insurance and capital market subsectors, the Malaysian financial landscape will be further enhanced.

"The more meaningful participation of ASEAN financial institutions in the domestic financial system and capital markets, coupled with greater operational flexibilities accorded to these institutions, will further promote a more competitive and dynamic domestic financial system that will support economic growth and development," she says.

One of the challenges facing the industry is the increasing popularity of FinTech (financial technology) companies which is disrupting the way traditional banking is being done.

"This creates a big challenge for traditional banks because they are not able to adjust quickly to the changes – not just in technology, but also in operations, culture, and other facets of the industry," says Datuk Siti Zauyah.

Another concern surrounding the rise of FinTech is the potential tax leakages and the challenge to tax revenue generated from e-commerce and other FinTech transactions which can easily bypass regulatory requirements.

Nonetheless, the Malaysian Government has positioned financial services to take advantage of disruptive technology such as FinTech in line with global trends. This includes the introduction of a conducive regulatory environment that harnesses the potential of FinTech to modernise, deepen and increase the competitiveness of the domestic financial and funding markets.

"FinTech is touted as a game changer, the revolution that is taking the financial services industry into a new era," says Datuk Siti Zauyah.

Datuk Siti Zauyah Md Desa, Deputy Secretary-General (Policy), Ministry of Finance.

MOVING FORWARD

The Malaysian economy has proven its resilience amid the uncertain global economic environment by advancing its strategic focus areas in the financial industry. In embracing the new normal, regulators and regulations have proved their ability to adapt. As there is a need for greater certainty around the regulatory agenda, policy must continue to empower the role of the financial system as a positive contributor to economic growth as well as an enabler for inclusiveness.

Financial institutions will now need to sharpen their strategic focus to remain relevant amid emerging competitors, shifting demographics, rising customer expectations and changing regulations. A conducive and robust business environment will remain pivotal to maintain the growth and sustainability of the industry.